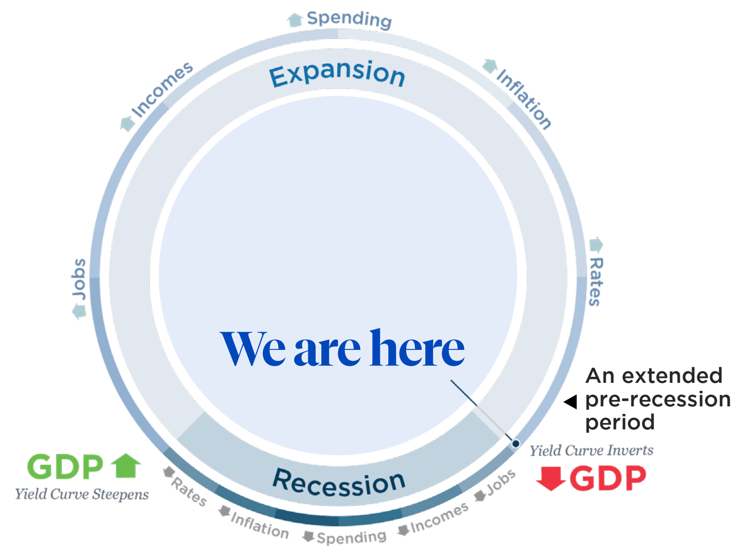
Economic & Financial Markets Monthly Review | November 2023

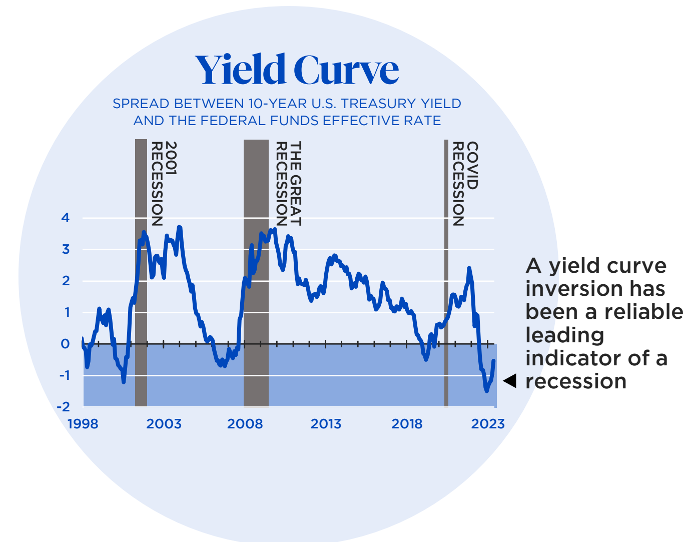
Consumer slowdown comes into better focus

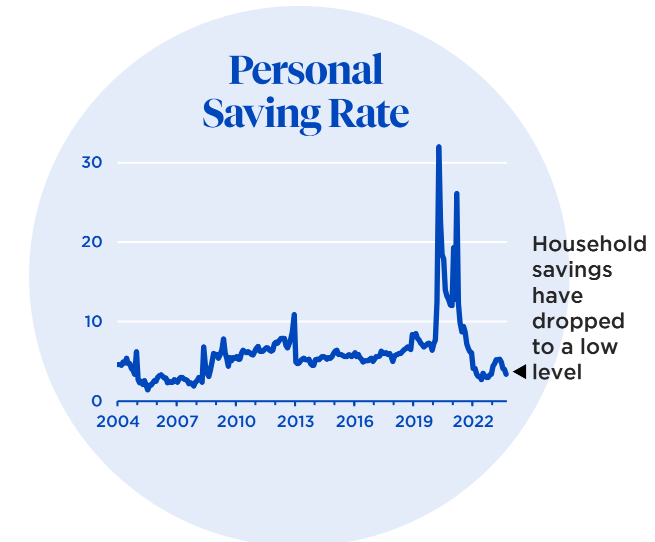
Economic Overview

Where is the economy now?

The resilient economic readings in September indicated a strong hand-off of activity heading into the fourth quarter, but the momentum for consumers and businesses is fading as the end of the year approaches. Financial conditions have tightened appreciably in recent months while cost pressures are building for many households — sapping much of the spending power generated by still solid hiring and income trends.







Where we are this month

RECESSION LIKELY DELAYED TO 2024

We expect weaker, albeit positive, growth in the fourth quarter, but the odds of a recession in 2024 remain elevated.

YIELD CURVE INVERSION LINGERS

The 10-year to fed funds rate spread remains inverted but steepened further with long-term Treasury yields hitting the highest levels since 2007.

CONSUMER SAVINGS DWINDLE

The personal saving rate dropped to 3.4 percent of disposable income in September, far below the pre-pandemic average of 5.0-6.0 percent.

What does this mean

- Leading indicators signal sluggish growth across multiple sectors in response to Fed rate increases, tighter bank lending standards, and weaker corporate earnings.
- A projected recession in the first half of 2024 should be modest with limited job losses and business closures — especially compared to the severe impacts over the past two downturns.

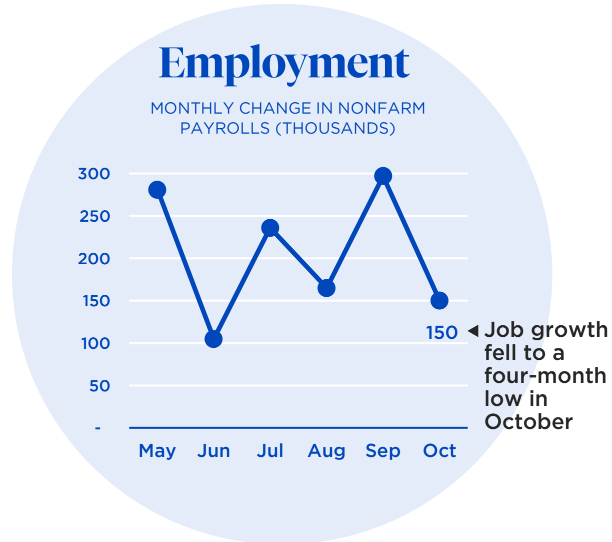
- The yield curve typically steepens ahead of downturns as the Fed eases policy to reduce recessionary impacts. This is less likely to occur over this cycle with the Fed projected to keep rates higher for longer over 2024.
- The sustained yield curve inversion is another warning sign for a recession, reflecting the bond market's elevated odds of a downturn over the next year.

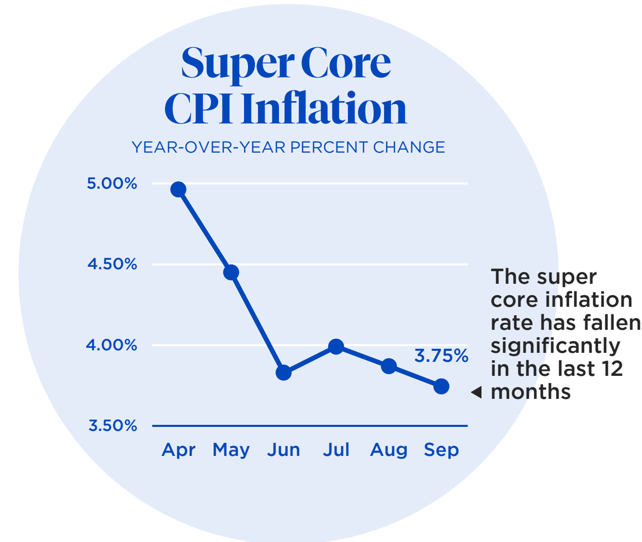
- Credit card debt has also climbed to record levels this year, suggesting that more households are being stretched by rising costs and higher interest rates.
- The lack of savings support should cause more households to cut back on spending in coming months, underlying the weaker outlook for growth heading into 2024.

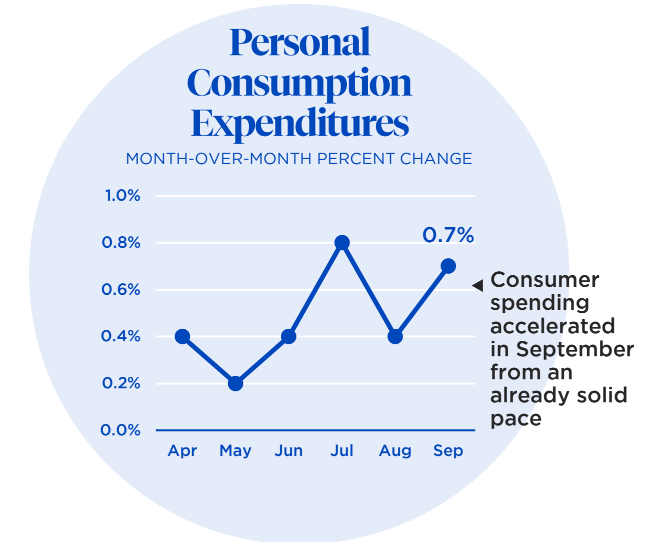
Economic Review

Job growth slows; consumer activity should follow

Hiring decelerated to a four-month low in October and large downward revisions to prior months suggest labor demand has weakened more than the initially reported blowout figure for September signaled. Solid job and income gains as well as households tapping into savings fueled a strong third quarter for consumers. However, spending is expected to cool sharply in the fourth quarter, led by signs of reduced need for workers.







Where we are this month

JOB GROWTH SLOWS IN OCTOBER

Nonfarm payroll growth slowed in October to 150,000 — a four-month low as more employers look to cut back expenses.

SUPER CORE INFLATION STILL ELEVATED

Year-on-year super core CPI inflation (i.e., core services less rents) fell in September to 3.8 percent — down from 6.5 percent a year ago.

CONSUMER SPENDING STILL STRONG

The spending spree for households extended through the end of the third quarter as consumer spending climbed 0.7 percent in September.

What does this mean

Job growth:

- Downward revisions to September and August totaled 101,000, painting a much cooler picture of labor demand. Job growth was weak aside from gains in healthcare and local government, suggesting that hiring has slowed across many sectors.
- Wage growth cooled further but remains above 4.0 percent, faster than the 3.5 percent posted pre-pandemic. The labor market remains tight as over 1.5 job openings exist for each unemployed worker.

Super core inflation:

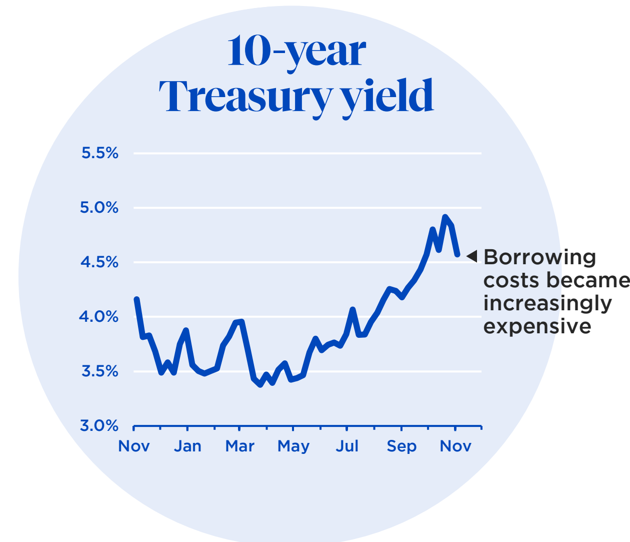
- Inflation for services has fallen moderately since hitting a peak in September 2022, but remains far too high for the Fed's comfort and is driving up costs for businesses.
- Transportation services are the largest contributor to super core inflation, followed by recreation services. Conversely, falling medical services costs are adding some slight disinflationary pressure.

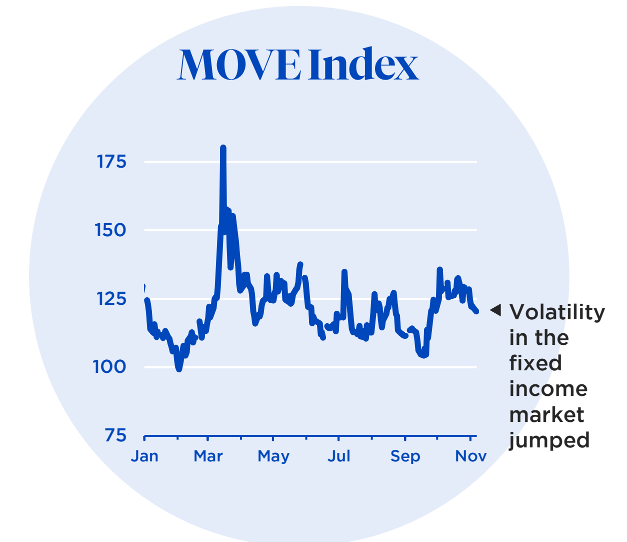
Consumer spending:

- Consumers spent freely on goods and services in the third quarter. To do so, most exhausted the remaining excess pandemic-related savings while dipping further into everyday savings.
- With job and income gains slowing and given that personal savings are not a sustainable source of funding for consumer activity, spending is expected to slow significantly in the fourth quarter.

Higher rates pressure equity markets

The S&P 500 lost further ground in October as interest rates hit fresh multi-year highs and the Fed affirmed its commitment to keeping policy restrictive for longer than usual. Fed officials are unlikely to ease anytime soon since they aren't fully convinced that inflation pressures have been sufficiently contained. We continue to expect that expensive borrowing costs and a persistent tightening of lending standards will spur a mild recession in 2024.





Where we are this month

EQUITY PRICES CONTINUE TO DESCEND

The S&P 500 fell roughly 2.0 percent in October. The benchmark stock market index finished the month roughly where it stood in the early summer.

INTEREST RATES CLIMB

The 10-year Treasury yield averaged 4.8 percent in October, its highest level since 2007. Higher real interest rates, or nominal yields minus inflation, were a key factor in the rise.

BOND MARKET VOLATILITY SURGES

The Bank of America/Merrill Lynch MOVE index, a measure of bond market volatility, jumped in October amid strengthening crosscurrents in financial markets.

What does this mean

Equity prices:

- Rising interest rates dampened equity investors' outlook, though encouraging economic data offered a partial offset. Most sectors recorded declines, led lower by energy and consumer discretionary stocks.
- The equity market's valuation dipped last month but stocks remained expensive. The P/E ratio for the S&P 500 averaged roughly 19.0, remaining above its long-term historical average.

Interest rates:

- The 2-year Treasury note yield, which is sensitive to the Fed's interest rate policy, increased modestly in October as Fed officials repeated their hawkish stance on monetary policy.
- Higher borrowing costs are a core feature of tighter Fed policy. The central bank is committed to cooling the economy as it strives to lower inflation to the two percent target.

Bond market volatility:

- A spike in geopolitical uncertainty added to the challenging investment landscape as economic data sent a persistently positive message but lending standards stayed tight and Fed officials signaled they will keep interest rates in restrictive territory.
- Investors will likely remain concerned of the outlook as the most recent economic data point to weaker economic growth amid stubborn inflation pressures and high geopolitical tensions.

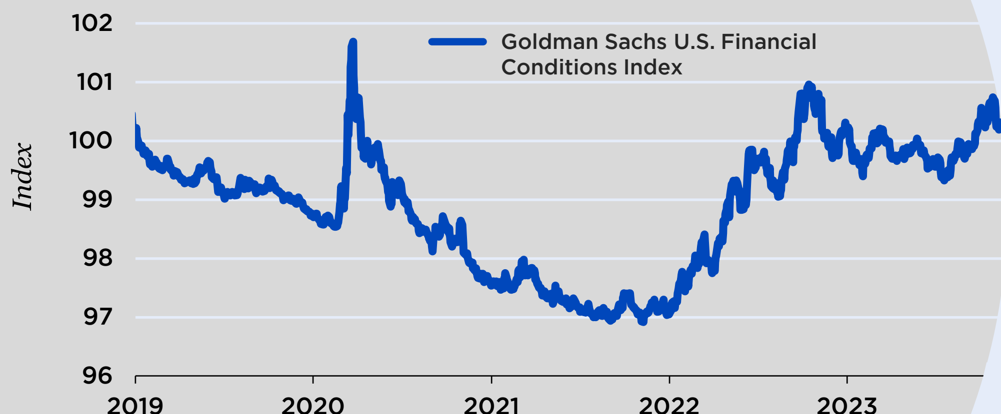
Outlook

Tighter financial conditions may mean no more rate hikes

Financial conditions in the U.S. have tightened sharply since August with the 10-year Treasury rate hitting 5.0 percent for the first time since 2007, the dollar strengthening, and banks pursuing more restrictive credit standards. This is likely to do some of the work for the Fed by reducing consumer borrowing and business investment over the fourth quarter and into 2024 — even with policy rates on hold at the last two FOMC meetings.

The overall financial tightening is a sign that previous rate moves by the Fed are more fully taking hold and that the higher-for-longer message has been priced into the market. As long as incoming labor demand and inflation data cools further, we expect Fed tightening to be at its apex with no additional rate hikes over this cycle. Importantly, this does not mean that rate cuts should be expected anytime soon as an extended period of restrictive monetary policy is likely needed to put inflation on a path to the Fed's 2.0 percent target.

Financial market tightening should aid the Fed



Podcast
Treasury joins the Fed in the spotlight
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19 min

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Data as of November 2023

	2022 ACTUAL	2023 ESTIMATE	2024 FORECAST	2025 FORECAST	2026 FORECAST
REAL GDP	2.1%	2.4%	0.7%	1.8%	1.6%
UNEMPLOYMENT RATE	3.6%	3.7%	4.6%	4.4%	4.0%
INFLATION [1] (CPI)	7.1%	3.6%	2.9%	2.4%	2.1%
TOTAL HOME SALES	5.67	4.82	**4.66**	**5.40**	6.00
S&P/CASE-SHILLER HOME PRICE INDEX	5.8%	5.1%	2.2%	3.5%	3.2%
LIGHT VEHICLE SALES	13.8	15.4	**15.1**	**16.3**	16.5
FEDERAL FUNDS RATE [2]	4.25%	5.25%	4.00%	3.00%	2.50%
5-YEAR TREASURY NOTE [2]	3.99%	4.50%	3.80%	3.00%	2.90%
10-YEAR TREASURY NOTE [2]	3.88%	4.60%	4.00%	3.45%	3.25%
30-YEAR FIXED-RATE MORTGAGE [2]	6.42%	7.60%	**6.30%**	**5.10%**	4.60%
MONEY MARKET FUNDS	2.27%	5.09%	4.65%	3.40%	2.59%

[1] Percent change Q4-to-Q4
[2] Year-end

Auto and home sales likely to drop in 2024

High financing rates and rising unemployment should reduce big-ticket purchases over 2024 as many households look to rein in expenses. Sales activity should bounce back in 2025 with interest rates easing, although low inventory of listed homes could remain a concern for several more years.

Mortgage rates also higher for longer

The 30-year fixed mortgage rate should run above 7.0 percent for much of 2024, pricing many buyers out of the market and causing most current homeowners to remain in place. Rates should decline later next year but are not expected to drop below 5.0 percent until 2026.

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Sources

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	Business Cycle	*Nationwide Economics*
	Yield Curve	*Bloomberg; National Bureau of Economic Research*
	Personal saving rate	*Bureau of Economic Analysis*
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	Nonfarm payroll gains	*Bureau of Labor Statistics*
	Consumer Price Index	*Bureau of Labor Statistics*
	Consumer spending	*Bureau of Economic Analysis*
3 |	**Financial Markets Review**	
	S&P 500	*Standard & Poor's*
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